

**Testimony of Richard S. Swanson**  
**Chairman of the Board, HomeStreet Bank**  
**Before the Federal Housing Finance Board**  
**December 2, 2002**

I am Dick Swanson, Chairman of HomeStreet Bank, a Seattle, Washington-based savings bank with approximately \$1.6 billion in total assets. Our bank is a member, and therefore a stockholder, in the Federal Home Loan Bank of Seattle. In addition I have served as an elected director of the Federal Home Loan Bank's Board of Directors, and currently serve as vice chairman. I deeply appreciate the opportunity to participate in this hearing.

I was an attorney in private practice prior to joining HomeStreet Bank some 16 years ago. In that capacity, I provided counsel on financial disclosures to public and private entities, on the both the issuer and investor sides. More recently, I have chaired the Washington Tobacco Settlement Authority, which issued \$500 million in tobacco bonds in early November of this year supported by one of the most complex disclosures (or "Official Statement") that one could ever imagine. My experience by no means makes me an expert. However, it has given me a breadth of understanding about financial disclosures and the critical discipline they provide in the marketplace.

I offer my remarks today on behalf of the Federal Home Loan Bank of Seattle and our board, representing 374 members that own the Seattle Bank. I speak as a member and stockholder with more than \$33 million, over one fourth of our total stockholders equity, in Federal Home Loan Bank stock and with \$584 million dollars in advances outstanding. HomeStreet Bank is primarily a housing lender, and Federal Home Loan Bank advances fund about 40 percent of our assets. Our home loan bank membership is critically important to our bank's strategies and performance. As a result, issues that affect the Federal Home Loan Banks are critically important to us as well. And I'm interested in seeing the issue of financial disclosure discussed and handled thoughtfully, in a manner that effectively and efficiently serves the interests of stockholders, investors and the public.

I'll add that in a 7,000-plus member system as diverse as the Federal Home Loan Bank System, it would be presumptuous of me to say that my remarks represent all of the membership. However, I believe that my views do reflect widely held sentiments among many members and their trade associations who support full and timely financial disclosure to underscore the importance of corporate accountability.

In the written joint testimony submitted by America's Community Bankers, the American Bankers Association and the Independent Community Bankers of America, the trade associations stated: "The members of the FHLB System strongly support full, accurate, transparent and enhanced securities disclosures that are appropriate for the unique cooperative structure of the System and carried out through the Finance Board in consultation with the SEC."

Now these trade associations have been studying the issue of Federal Home Loan Bank financial disclosure requirements for some time, as have the home loan bank presidents that are testifying today. I, on the other hand, am a relative newcomer to this discussion. The week before last, when I attended our all-system meeting of Federal Home Loan Bank directors in Washington, was my first opportunity to participate directly in discussions about possible changes to the disclosure regime for the Federal Home Loan Banks. And I'll have to say that I am somewhat puzzled by the approach taken to this extremely important and sensitive matter. As shareholders, we clearly have the most immediate and direct stake in this discussion but I have yet to hear a satisfactory explanation of exactly what disclosure problems or deficiencies advocates of change believe they are solving.

It's apparent that the Federal Home Loan Banks, the Finance Board, Treasury and others agree that current political sentiment calls for an increase in the transparency of the Bank System's financial activities and easier access to such information. As best as I can discern, that sentiment led very quickly to a question of jurisdiction – which agency should have authority in this area. But I think the discussion skipped a beat by failing to first ask: what is the nature of the problem we are trying to address? I think we may be a bit ahead of ourselves.

Changing disclosure practices is an action that should be made thoughtfully and deliberately, based on solid analysis and input from those who use the disclosures. Transparency and availability of accurate financial information provide the foundation of our capital markets that are the envy of the world. The purpose of financial disclosures is to ensure that investors, and those who support and facilitate the capital markets have complete, accurate, and timely information that is material to their investment decisions.

I would first ask: what evidence do we have that investors or members are dissatisfied with the information the Bank System is presenting? What are the specific deficiencies? What problem are we trying to remedy?

As I have listened to discussions about proposed changes in disclosure regulation for the Bank System, I believe that confusion occurs when clear distinctions are not made between debt and equity. There are critical distinctions between the Bank System's debt and equity, and even more important distinctions between the Bank System's debt and equity and those of other companies. These differences must be acknowledged and thoroughly understood if the Finance Board and others are to make good decisions about disclosure practices.

First, let's consider the Bank System itself. The Federal Home Loan Bank System provides wholesale mortgage funding through twelve independently, cooperatively owned banks. Each manages its own operations and financial performance under the oversight of its own board of directors. Each bank has its own management team and is capitalized by its own membership, through its own individually designed capital structure as provided under the Gramm-Leach-Bliley Act of 1999. As a member, I value the regional nature of the Bank System and the high level of member service and responsiveness that comes along with it.

Despite all of this independence, the Federal Home Loan Banks are required by law to jointly fund their operations through their issuance of consolidated obligations (CO's) in the capital markets. This activity occurs through the Bank System's Office of Finance, with each of the 12 home loan banks joint and severally liable for the debt issued and outstanding. This collective issuance activity is a unique characteristic of the Federal Home Loan Bank System's debt. No other corporate entities issue debt in the publicly traded capital markets in a similar manner, including Fannie Mae and Freddie Mac.

Over the years, an elaborate system of financial disclosures has evolved under the leadership of the Office of Finance, and under the regulation of the Finance Board, to provide the type and frequency of material information demanded by investors in the marketplace for these debt securities. Much of the financial disclosure regime related to the Bank System's CO's parallels the SEC rules that have developed for more typical corporate issuers. However, the financial information disclosed is unique in that it provides a combination, not technically a consolidation, of the financial statements from each of the twelve banks that, by statute, are jointly and severally liable for the debt. Regulatory jurisdiction over this disclosure system is appropriately lodged with the Finance Board, and it has worked very successfully.

In fact, at the recent system-wide directors meeting I asked senior members of two leading investment banking firms who deal extensively in the CO market what changes, if any, they would suggest in financial disclosures currently provided for the Bank System consolidated debt, either to better satisfy investor requirements for information or to improve pricing of the debt. They both replied that the current disclosure system is adequate and effective, that it has evolved successfully over time to reflect changes in the individual banks and the Bank System, and that they expect such disclosures to evolve with future changes, such as increased concentration in acquired mortgage assets, under the regulation of the Finance Board.

I want to emphasize this not because a proposed change in jurisdiction over regulation of financial disclosures related to the debt securities of the home loan banks is before us today. I emphasize it instead because it is in the market for debt securities of the system, not in a market for Federal Home Loan Bank stock which I will discuss in a moment, where we find typical financial investments being made, with the related need for typical market financial disclosures that are similar to those mandated by the SEC. And it is in this very debt market, with a dollar value of over 20 times the amount of Federal Home Loan Bank stock at any given time, where we find the Federal Home Loan Bank System, under the capable regulation of the Finance Board, performing very well, without suggestions for radical change. The Finance Board has proven to be an effective disclosure regulator for this significant amount of publicly traded debt that is sold by a uniquely structured issuer.

Now, turning to the equity securities issued by the Federal Home Loan Bank System, we have very different securities characteristics and issues but they lead to the same conclusion: that regulation of financial disclosures is most appropriately handled by the Federal Housing Finance Board.

Unlike the debt securities, which are issued on a system-wide basis and involve a unique issuer structure, each Federal Home Loan Bank – a discrete, identifiable legal entity – issues stock. However, what is unusual on the equity side is that decisions to purchase stock are not made for the reasons or in the manner a typical investor would make an investment decision to purchase an equity security. Accordingly, the financial disclosures that would support a typical stock investment decision in the marketplace are not at all suited to the Federal Home Loan Bank situation.

Each Federal Home Loan Bank has its own stock that is purchased by the members in its region. This stock cannot be sold to the public at large. You can't buy it from a stockbroker. There is no ticker symbol for it. The market price doesn't go up and down. The stock has a constant par value of one hundred dollars per share. Only a small number of sophisticated investors – all of whom are financial institutions – can buy this stock.

When a bank first acquires Federal Home Loan Bank stock it is usually incidental to a decision about whether to become a member of this wholesale bank cooperative system in order to have

access to its products and services. Financial returns on this initial investment are generally of secondary importance.

When my bank changes its position in Federal Home Loan Bank stock, the amount we purchase or sell is dictated by the composition of our balance sheet and our utilization of Federal Home Loan Bank services. The investment is a condition of our membership and the amount of the investment required depends on our size and our use of the home loan bank's products and services over time. It's an investment we make because we want use of the cooperative's services. This is not the case with stock purchases one would make in the public equity market. Federal Home Loan Bank stock is a very different investment, purchased in a very different way and for different reasons, than other equities including those of our fellow housing GSEs, Fannie Mae and Freddie Mac. I measure the return on my investment in the Seattle Bank based on the value I receive through advances, the Mortgage Purchase Program, the Affordable Housing Program and other services as well as the earned dividend. This is a very different value proposition than the typical equity investment. And evaluating this value proposition requires very different information than would be required of the typical corporate stock issuer registered with the SEC.

Financial disclosure will be effective only if it captures the Federal Home Loan Bank System's unique structure and cooperative arrangement, and it provides information relevant to the complex and unusual business decision made by a member bank when it is increasing or decreasing the amount of home loan bank stock it holds.

The Bank System is fundamentally different. No one can deny that. Just as an effective disclosure system has evolved, under the regulatory authority of the Finance Board, to support investor requirements and an efficient market for Bank System debt securities, so is a disclosure system evolving for the equity securities issued by the individual Federal Home Loan Banks pursuant to capital plans implemented under the Gramm-Leach-Bliley Act.

The Seattle Bank has been the first (and so far only) bank in the System to implement its new capital plan as mandated by the Gramm-Leach-Bliley Act. Because this involved new investment decisions for every stockholder of the bank, our Board of Directors, management and staff took very seriously the Bank's disclosure responsibilities under existing regulations, statutes such as Section 10(b)5 of the Securities and Exchange Act of 1934, and common law. Working in cooperation with the Finance Board, the other home loan banks, and legal counsel, the Seattle Bank developed a disclosure document that was intended to provide all material information needed by the stockholders to make their investment decisions. Not one of our 374 stockholders, all of whom are financial institutions and presumably very sophisticated investors, requested additional financial disclosures. And this complex recapitalization took place at the height of public concern about corporate responsibility and adequacy of financial disclosures following the Enron and WorldCom debacles. I'll add that while there has been tremendous turmoil in the public equity and debt markets regulated by the SEC, the Federal Home Loan Banks' debt issuance and capital stock activities have not generated controversy. Were there concerns, you can be sure that the associations representing members of the financial services industry would be calling for reform today. That is not the case.

I made the point earlier that changing disclosure practices is an action that should be undertaken thoughtfully and deliberately, based on solid analysis and input from those who use the disclosures. The first question we must ask is what additional or enhanced disclosures are needed, by whom, and for what purpose. As I have participated in discussions about possible changes in regulation of Bank System disclosures, I feel like I am one of the few people asking that question. What substantive changes are needed? Who needs them? And why? Only when these questions are

answered should we proceed to the next step, which is to ask how enhanced disclosure can best be provided.

For those of us who have practiced securities law or been directly involved in the financial disclosure system that underpins our capital markets, there is no doubt that the acronym “SEC” has the connotation of “gold standard.” However, that does not mean that the Federal Home Loan Banks, as both “unique issuers” of debt and issuers of “unique stock” would improve the quality or effectiveness of their financial disclosures by transferring regulatory responsibility for their financial disclosures to the SEC. I have not heard officials of the SEC calling for specific changes in the financial disclosures made by the home loan banks. Nor am I aware that the SEC has demonstrated that it can be a more effective regulator of the Federal Home Loan Bank System disclosure system than the Finance Board.

If thorough analysis and research justifies it, I fully support the idea of modifying and improving Federal Home Loan Bank reporting to more fully capture all necessary and appropriate disclosure requirements set forth in the Securities Exchange Act of 1934. And from my perspective, it’s not only logical but also essential that the Federal Housing Finance Board, as part of its strong and comprehensive supervision of the Federal Home Loan Bank System, should be responsible for overseeing these reporting and disclosure practices.

The Federal Housing Finance Board is a strong and effective regulator of the Federal Home Loan Bank System. There is no better evidence of this than the fact that, in its 70-year history, the Bank System has never experienced a credit loss, never cost the taxpayer a dime and never even tapped its emergency line of credit with the Treasury Department. Chairman Korsmo has brought an even stronger focus on safety and soundness regulation as evidenced through his recent restructuring of the agency, which substantially increased staffing in the supervision area. Under his leadership, the Federal Home Loan Banks have moved forward with adopting risk-based capital requirements and implementing their new capital plans in just three years – far less time than has been required by other housing GSE regulators to just finalize risk-based capital standards. In the Finance Board, we have a strong regulator that has diligently created and forcefully carried out very high quality financial disclosure and reporting requirements.

I should note that Congress created the Finance Board so that it would have close and intimate knowledge of the business and financial condition and operations of each of the 12 Federal Home Loan Banks. As a member of the Bank System, it gives me great confidence that each regional bank undergoes such intense scrutiny. I can be confident not only in the regulation of the Seattle Bank, but also in the operations of the sister banks. That’s critically important to all members, given the nature of the joint and several liability. It is also critically important to the American public that depends on the Finance Board, backed by \$30 billion in private member capital, to protect their interest in this system.

Developing and implementing financial disclosures to provide meaningful, material and transparent information to investors is a logical element of the Finance Board’s regulatory activities and its focus on safety and soundness. It is what the Finance Board was designed to do by law. Nothing has changed that casts doubt on the ability of the Finance Board do its job effectively and nothing has changed in law that indicates Congress desired a change in jurisdiction. Unlike the SEC, the Finance Board knows the Bank System inside and out, including all of its unique aspects. It won’t have to make the square peg fit the round hole. As a shareholder, I have much greater confidence that the Finance Board will best protect my interests as an investor, not because it is the agency most familiar with financial disclosure regulation in the public equity markets but instead because it is intimately familiar with the Federal Home Loan Bank System – and with the unique membership

as well as investment attributes of the Federal Home Loan Bank stock which is not sold in the public markets.

The Finance Board can and does borrow the best disclosure practices from the SEC and tailors them to this unique system. As the risk profile of the twelve banks evolves, so too should the Finance Board continue to enhance reporting and disclosures to adopt the highest standards of transparency and openness.

Changes have occurred in the public markets and this has resulted in greater rigor in those markets, much of which the Finance Board can apply to the home loan banks. The Federal Home Loan Banks are already working together with the Finance Board to implement a state-of-the-art disclosure framework for the regional banks and the system that would be administered by the Finance Board. This framework would deliver disclosure both for the individual bank and the system at a level that mirrors that of SEC-reporting companies with modifications necessary to reflect the Federal Home Loan Banks' unique characteristics. This includes the standard 10-K, 10-Q and 8-K reports that we are all familiar with. The Federal Home Loan Banks would also post them on-line, as public companies do, to promote easy and timely access to extensive financial information. These are just a few examples of the expanded disclosures that could be implemented for the Bank System, if determined appropriate by the Finance Board.

As a member, I am obviously concerned by the idea of moving jurisdiction to the SEC. The Bank System has a capable regulator able to implement any necessary changes in disclosure practices. The transfer of jurisdiction would be complex and could have unintended consequences in the capital markets with no added protection to investors such as my institution. Further, it would add unnecessary costs and needlessly distract the Bank System from its congressionally chartered mission of serving members and advancing housing and community development throughout the nation. Finally, I am also concerned that the efforts of a regulator unfamiliar with the unique aspects of the Federal Home Loan Bank System to apply a disclosure regime designed for a different type of issuer and entirely different investment decisions could result in unintended changes to those unique aspects of the Bank System that make it so valuable to housing lenders like HomeStreet Bank.

In closing, I acknowledge and respect the public and political sentiment favoring greater access to the financial information of all companies. As one who has worked throughout my professional career as a lawyer and banker, with the financial information that our capital markets rely upon to function effectively, and as the Chairman and an owner of a member bank that holds \$33 million in Federal Home Loan Bank stock, I fully support Chairman Korsmo's aspiration that the Federal Home Loan Banks should become "role models for accountability and disclosure." However, fulfilling this aspiration requires us to continue to focus on the substance of our financial disclosures, specific changes appropriate to our unique structure and stock that should be made, and how those changes can be made most effectively. I encourage the Federal Home Loan Banks and the Finance Board to engage with the members who own this system to determine precisely how to improve disclosures in ways that are meaningful for investors. Such cooperative effort has worked successfully in the past, and it is the best way to continue evolution of an enhanced and state-of-the-art disclosure system for the future.

Should greater disclosure be warranted to better serve the interests of the regional banks, members, investors and taxpayers, then I believe those interests can be best served through an enhanced financial reporting and disclosure regulation that is administered by the Finance Board and reflects the unique characteristics of the Federal Home Loan Bank System. On behalf of the shareholders of the Federal Home Loan Banks, I thank you for your leadership in the area of corporate responsibility, transparency, and financial disclosure – but I also ask that you take

appropriate credit for successfully regulating financial disclosures of the Federal Home Loan Bank System in the past, and that you have confidence that you are the best suited and fully up to this important task in the future.

Thank you for the opportunity to participate in this public discussion on this important matter.